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April 2019

First Quarter Fixed Income Letter to Clients

The US bond market posted a strong first quarter for 2019, following the strong fourth quarter of 2018. The 10-year US Treasury yield ended the quarter at 2.41%. This modest growth, low inflation environment has allowed the fed to step back from its tightening stance, and instead take a wait and see approach which is ideal given last year's consensus view that inflation was likely to pick up soon.

The Tax-Free Municipal Bond benchmark index ended the quarter with a positive return year to date of 2.49%. Particularly strong returns came from the long end of the yield curve. We expect to see tax-free municipal bonds remaining strong. Reinvestment outpace modest issuance, yielding net negative supply (i.e. more bonds are called, refunded or mature than new bonds issued). And we think that it is highly likely that demand will continue to be rock solid as higher income tax payers feel the effects of tax reform.

We believe that it is the most probable scenario that the US bond market will continue to be firm. And for those in the high income tax brackets, municipal bonds offer the best opportunities for fixed income investors. Although continued strong performance has resulted in extended relative valuations, especially in the front and middle ranges of the yield curve, we remain constructive with respect to municipal bonds. We anticipate that issuance will remain manageable and retail demand may strengthen further as investors are likely to place a higher value on the tax advantages of municipal bonds.

Our current strategy for municipal-bond investors continues to be to own a diversified portfolio of high-quality, investment grade bonds maturing in one to ten years. For clients who reside in high income tax states, we focus on buying a diversified portfolio of bonds issued in their state (when possible) in order to benefit from the state tax exemption. We also buy out-of-state bonds for the purpose of credit diversification.

Our client's portfolios are designed to earn optimal after-tax return while maintaining a relatively defensive portfolio structure given today's interest rate environment. Of course each client has a unique set of circumstances that we focus on in order to customize the portfolio towards meeting their goals and investment objectives. Tax-free income, preservation of principal and targeted duration management is what makes a municipal bond portfolio an attractive investment for clients in a high tax bracket.

Evan Slater
Fixed Income Portfolio Manager